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SUBJECT: BRAZIL: FINANCE MINISTRY REACHES OUT TO G-8 EMBASSIES

¶1. Action Request - paragraph 6.

¶2. (SBU) Summary. On February 2, the Ministry of Finance's Assistant Secretary for International Affairs, Luiz Pereira, called in Emboffs from the German, French, Italian, Canadian, Japanese, British, Canadian, and U.S. Embassies to brief on the themes that FinMin Palocci has discussed during recent G-8 and G-20 sessions. Key among the Minister's concerns were perennial GOB hobby horses such as the creation of a new IMF facility for moderate income, low risk countries such as Brazil and the establishment of international tax to fight hunger. During the course of the February 2 session, Pereira proposed that the group meet informally every three months or so (prior to upcoming G-8 sessions) to discuss pending macro and micro issues related to both the Brazilian and the world economy. While Pereira characterized the proposed meetings as an informal discussion group involving G-8 countries, our guess is that part of the motivation for the idea is simply to reduce the number of bilateral meetings with key embassies by meeting with them en masse. We suspect that at any future sessions, as was the case at the first, the GOB will do most of the talking. End Summary.

¶3. (SBU) Pereira began by noting that in Finance Minister Palocci's remarks at both recent G-8 and G-20 meetings, the latter has emphasized five general themes: a) risk scenarios for the worldwide economy, b) the potential for a soft landing in the wake of necessary adjustments, c) the need to reform the international financial architecture (i.e., create a new IMF line of credit for countries such as Brazil), d) rethink the structure of international assistance, and e) the ongoing WTO Doha Round talks.

-- Risk Scenarios. On this point, Pereira chiefly noted the current prevailing high energy prices and the inability of producing countries to increase supply in the short-term, adding that any increase in worldwide refining capacity would be welcome as well. The degree to which Chinese demand would keep markets tight, he declared, was an open question.

-- Soft Landing. Pereira worried that strong growth in the new emerging markets (like Brazil), coupled with the United States's twin budget and trade deficits, might spark an abrupt - and painful - correction. Although he felt that the elements of the problem

could be dealt with, he acknowledged that there were a range of varying opinions on this issue - many of which had differing views on the pattern of international savings.

-- International Financial Architecture. Here Pereira lamented the fact that the IMF had no facility aimed at middle-income countries who desired a ready line of credit as insurance against possible external shock. What was needed, he concluded, was a serious rethink of the focus of the Fund's activities.

-- International Assistance. While Pereira acknowledged the recent HIPC initiative, he stated that more needed to be done to help out the poor. He then launched into a spirited argument in support of President Lula's 2004 UNGA hunger initiative, calling for international tax mechanisms to increase ODA.

-- WTO. On this issue, Pereira merely noted the greater level of insertion of the newly-emerging countries into the world economy - and underscored the importance to Brazil of the Doha Round talks on agriculture.

¶4. (SBU) Moving to the domestic economy, Pereira stated that in 2006 GDP would expand briskly regardless of who was elected president in the October elections. Interest rates would fall gradually during the course of year and, given the overall societal consensus on sound macro policies, the upcoming election would not lead to any significant appreciation of Brazil's EMBI country risk. That said, he did not foresee any significant micro reforms being enacted prior to the election, although perennial favorites such as tax reform, increased infrastructure investment, and incentives for export would remain on the agenda. In the longer term, he thought that the country's possible rise to investment grade status in 2007 would help to lower debt levels, while exports would remain stable, notwithstanding the strength of the Brazilian real, because of the

diverse mix of products and destinations. Finally, Pereira opined that the "right fiscal/monetary policy mix" (read: the passage of a budget-cutting mechanism after the election) would give the government the necessary space to cut interest rates even further.

¶5. (SBU) Pereira proposed that the group meet informally every three months to continue discussions. We suspect that at any future sessions, as was the case at the first, the GOB will do most of the talking.

¶6. (SBU) Post requests guidance on the appropriateness of participating in the series of informal meetings the GOB has proposed.

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